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REFLECTION RESOURCES LTD.

Annual Report 1985

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Cover: The cover of Reflection's 1985 Annual Report is a stylized representation of the Company's successful exploration activities in the Ebor-Daly area of southeastern Manitoba. Much of the Company's exploration initiatives in the coming year will be focused in this area.

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Corporate Profile

Reflection Resources Ltd. is a wholly-owned Canadian company, based in Calgary, engaged in exploration and development of oil and natural gas reserves in the western Canadian sedimentary basin and the United States.

The Company has lands in Alberta, Saskatchewan, Manitoba, Texas, Ohio, Illinois, West Virginia, and Pennsylvania. Reflection is actively exploring for oil in the Daly area of southwestern Manitoba.

The Company has oil and gas production from wells in the Tindastoll area of Alberta, Frys area of Saskatchewan, Ebor-Daly and Butler areas of Manitoba, Herald and Holmes areas of Ohio, Seneca Upshur and Brown Shale areas of West Virginia, and La Gloria Field in Texas.

Reflection was established in 1983, and has been listed on the Alberta Stock Exchange since June 1984 under the symbol REF. There are 5,538,366 common shares outstanding.

Corporate Philosophy

Reflection applies the skill and judgement of a team of experienced professionals to high quality oil and gas prospects in selected areas of western Canada and the United States.

The Company's objective is to grow, as quickly as is practical and prudent, into one of Canada's best managed independent oil and gas enterprises.

To do this, Reflection works cooperatively with other companies in its exploration and development activities. This method of operation has the combined benefit of reducing risks while drawing on the strengths that other participants bring to a venture.

1985 Highlights

Exploration

Participation in the drilling of exploration wells and the purchase of seismic data provided Reflection with valuable information on its prospects in the South Antler area of Saskatchewan.

Development

Reflection participated in the drilling of five development wells in Saskatchewan and Manitoba, all of which are now producing oil wells. Plans for the coming year involve increased drilling activity in both provinces, with expected participation in up to 20 development wells.

Production

Reflection's interests in producing oil and gas wells increased dramatically to include producing properties in all three prairie provinces and the United States.

Amalgamation with Corsair Petroleum Ltd.

Reflection amalgamated with Corsair Petroleum Ltd., allowing the Company to expand its asset base, increase cash flow, and add new lands for exploration and continued development drilling.

Guy Anderson, President and Chief Executive Officer (left), and George Longphee, Chairman of the Board.

President's Report to Shareholders

A number of significant accomplishments mark Reflection's second full year of operations. An expanded asset base, increased revenues from oil and gas production, and escalated drilling activity have contributed to your Company's ongoing success. Internal overhead has been reduced without hampering our ability to operate effectively, and the Company continues to farm out as much undeveloped acreage as possible. Changes in organizational structure and management have also improved Reflection's ability to grow with and adapt to a revitalized industry.

During 1985, major changes occurred in legislation affecting the oil and gas industry in Canada. New Oil Reference Price (NORP) supplements have been eliminated, and Petroleum Incentives Program (PIP) rebates will be phased out to zero as of April 1, 1986. As the deregulation process continues, renewed enthusiasm and confidence in the energy sector is paving the way for an exciting and prosperous future.

Amalgamation with Corsair

In 1985 Reflection amalgamated with Corsair Petroleum Ltd. Corsair's subsidiaries are Teebay Oil and Gas Ltd., Teebay Oil & Gas Inc., Corsair Petroleum Inc., and Antelope Oil & Gas Inc. Under the amalgamation agreement 2,238,336 Reflection shares were issued in exchange for all of the outstanding shares of Corsair Petroleum Ltd. The Company issued 250,000 shares which were paid to the agents who organized the amalgamation. The amalgamation was approved by shareholders in October 1985.

Reflection has also proposed a takeover of Blackrock Energy Ltd. in exchange for 1,800,000 shares with another 250,000 shares issued to the agents for arranging the transaction.

This proposal was also approved by shareholders in October 1985. At the time this letter was written, the transaction had not yet been completed. However, it is anticipated that the takeover will be completed in early 1986.

Financial

Revenue in 1985 from oil and gas production and from interest totalled $57,679, compared with $28,508 in 1984. It is anticipated with the recent completion of three additional oil wells in the Daly prospect that revenues should increase at least twofold in the coming year.

Reflection's fixed assets for 1985 have increased to $920,022 from the 1984 value of $731,851.

Your Company will be undertaking an equity financing in the first half of 1986 to provide capital needed to carry out planned drilling and land acquisition programs. To ensure that ongoing operations are adequately funded while equity financing or a private placement is being arranged, Reflection has established a $75,000 line of credit with the Royal Bank of Canada.

Your Company also intends to take full advantage of the benefits to be obtained from the proposed Alberta Stock Savings Program, which is soon to be adopted as law.

Exploration & Production

In 1985 Reflection participated in the drilling of five development wells in Saskatchewan and Manitoba, all of which are now producing oil wells. Gross production from these wells is 90 barrels per day (bopd), of which Reflection nets 8.6 bopd.

During December 1985, your Company participated in the drilling of two wells on lands in the Antler area of southeastern Saskatchewan. Reflection's share in the wells was 6% and 9%, with the remainder of the drilling costs farmed out. These exploration wells were both dry and abandoned. However, valuable geological information was obtained which will help determine future possible drilling locations.

During 1985 total oil reserves increased to 23.3 thousand stock tank barrels (mstb) from 4 mstb in 1984. Gas reserves totalled 181 million standard cubic feet (mmscf) from nil in 1984. The undiscounted value of the company's reserves totalled $1,446,000 for 1985, up from $256,000 in 1984. Total reserves discounted at 15% are valued at $428,700, up from $99,000 for 1984.

1986 Priorities

In the coming year Reflection will continue with the same general program philosophy — to develop our properties as much as possible at little or no cost to the Company, and to expand our asset base through production purchases.

Activity in the coming year will be increased in the West Butler and Ebor-Daly areas of Manitoba. It is anticipated that 15 development wells will be drilled in these areas, at an average 15% working interest per well. An estimated five development wells will be drilled in the Frys-Antler area of Saskatchewan.

Drilling activities in the U.S. will be minimal. Reflection expects to participate in two multizone development wells in Texas in 1986.

People

In October 1985, as part of the amalgamation with Corsair Petroleum Ltd., Reflection's Board of Directors was expanded to six members. The new directors are George Longphee, Donald Basso, and Robert Hyde.

At the October 1985 meeting the Board accepted the resignation of Director Wilda F. Pashak.

On behalf of the Board of Directors, I would like to thank our shareholders, friends, and associates for their support in 1985. Management is confident that Reflection can build on the successes of 1985 and make 1986 a banner year for your Company.

Respectfully submitted,

Guy R. Anderson
President & Chief Executive Officer
February 20, 1986

Operations Review

Exploration drilling and the purchase of seismic data in key areas show Reflection's ongoing concern with evaluating the potential of Company lands. Numerous development projects proved successful in 1985, adding to the growth of the Company's production base and increasing cash flow. Producing properties now include working interests in oil and gas wells in Alberta, Saskatchewan, Manitoba, and the United States.

Exploration

In 1985 Reflection's exploration activities were focused on drilling in the South Antler area of Saskatchewan and in the West Butler area of southwest Manitoba.

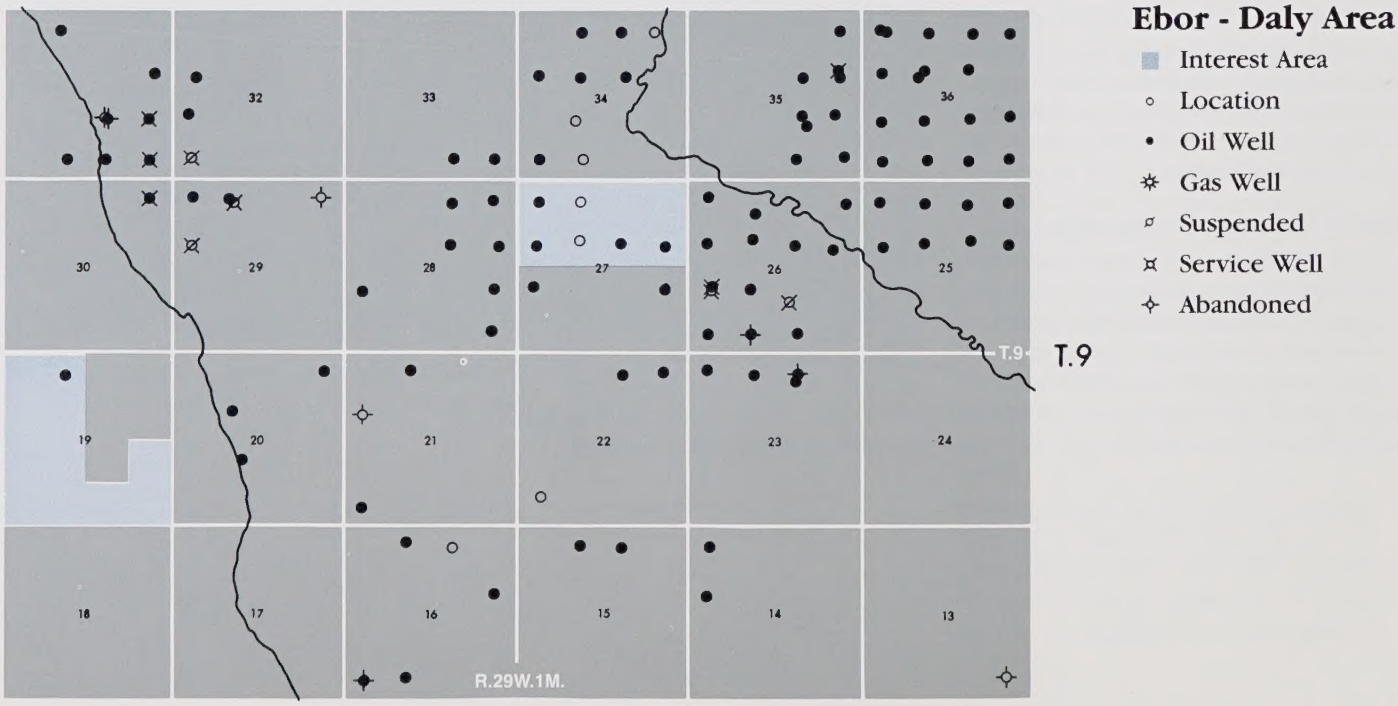
In the South Antler area, wells were drilled at 6-10-7-30-W1M and 2-26-7-30-W1M at minimal cost to the Company. Unfortuntely both wells were dry and abandoned. Five miles of seismic data was purchased in the South Antler area, and this data identified a prospective drilling feature. Further data from this area will be purchased to enable Reflection to prepare an appropriate presentation for companies which may be interested in farming in.

Near the end of the year, the Company was evaluating a farmout program in the West Butler area of Manitoba. By December 1985 Reflection had made an agreement providing for an exploration well to be drilled by Newscope Resources Ltd. Arrangements were made for the well to be completed before the end of 1985.

Development

A development well was drilled in the Frys field of southwestern Saskatchewan, resulting in a 10 bopd well. The Company is now making efforts to increase the potential production of the area through reduced acre spacing. In cooperation with Bedford Petroleums, the single largest operator in the Frys field, Reflection has applied to the Saskatchewan government for 40 acre spacing in this field. Approval is anticipated by the end of June 1986.

In 1985 four development wells were drilled in the Daly-Ebor area of Manitoba, resulting in a combined production of 80 bopd. Two further wells will be drilled in this area in January 1986, and two additional spacing units may also be drilled. The Company has a 7.6% working interest in these lands.



Production

Reflection's interests in producing oil and gas wells increased dramatically in 1985. The Company expanded its production base to include all three prairie provinces, as well as producing properties in the United States.

In Alberta, Reflection owns a 3.5% gross overriding royalty interest in one producing oil well in the Tindastoll area. This well is producing at a rate of 30 bopd. The Company also has a net working interest of 7% in one shut-in oil well in the Strathmore area, as well as a 3.13% net working interest in one shut-in gas well in the Hespero area.

In the Frys area of Saskatchewan, Reflection has a 25% net working interest in one oil well, which is producing at a rate of 10 bopd.

In Manitoba, the Company has a 7.6% net working interest in four producing wells in the Daly-Ebor area, with a combined gross production of 80 bopd.

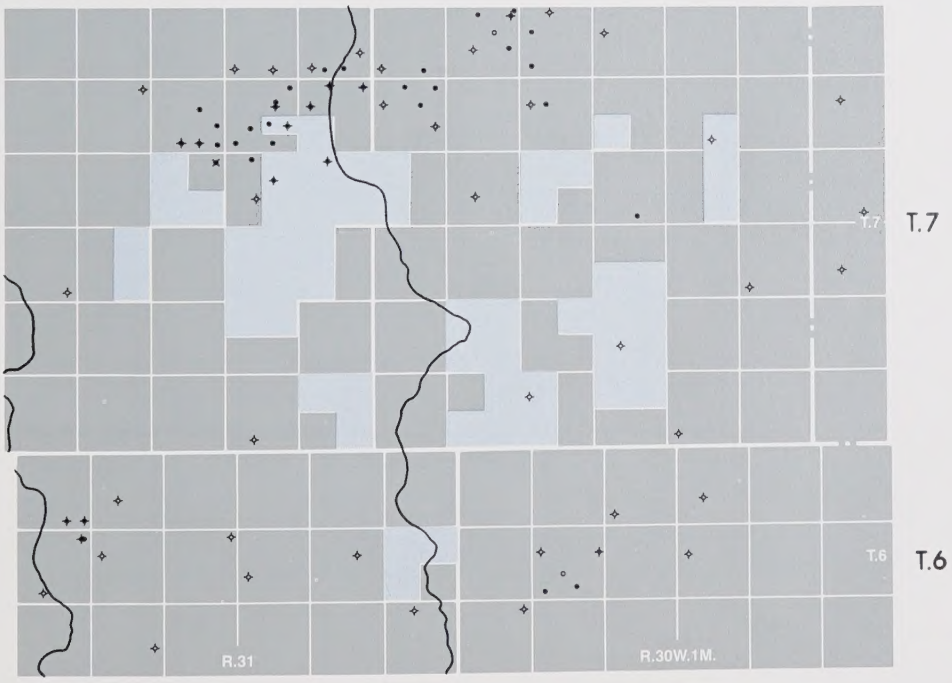
The Company's interests in the U.S. include a 2.08% net working interest in two producing gas wells and one producing oil and gas well in the La Gloria field in Texas, as well as varied interests in oil and gas properties in Ohio and West Virginia.

Land Holdings

	Gross (acres)	Net (acres)
Canada	8,400	3,182
United States	9,611	1,276
Total	**18,011**	**4,458**

Oil & Gas Reserves

	Crude Oil (thousands of barrels)	Natural Gas (millions of cubic feet)	Undiscounted x1000	Discounted 15% x1000
Alberta				
Proven	2.3	57	$ 497	$ 64
Probable	2	—	34	19
Saskatchewan				
Proven	6	—	59	18
Probable	—	—	—	—
Manitoba				
Proven	8	—	72	54
Probable	—	—	—	—
United States				
Proven	5	93	613 (CAN)	244 (CAN)
Probable	—	31	352 (CAN)	29.7 (CAN)
Total	**23.3**	**181**	**$1446**	**$428.7**



Frys - Antler Area

- Interest Area
- Location
- Oil Well
- Gas Well
- Suspended
- Service Well
- Abandoned

Management's Review of Financial Position

During its second full year of operation, Reflection successfully completed an amalgamation with Corsair Petroleum Ltd. This allowed the Company to expand its asset base, increase cash flow, and add new lands for exploration and continued development drilling.

Net loss for 1985 was $359,056 (11 cents per share). Further reference may be obtained from the Financial Statements which follow this review.

As at October 31, 1985, Reflection showed an increase in revenue of $29,171 over the beginning of the period.

Reflection is currently reviewing producing oil and gas properties for a possible purchase by the Company. A purchase is expected, provided acceptable financing can be arranged by the Company.

To keep expenses down until there is an increase in revenue from operations, Reflection will be reducing the Company's overhead as much as possible in the first and second quarters of 1986. Bridge financing has been put in place to allow the Company to continue development drilling in Manitoba.

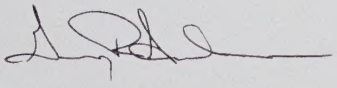
Reflection's management team discusses the Company's prospects in the Antler area of southeast Saskatchewan. From left to right: Directors Jim Stapleton and Don Basso, President and Chief Executive Officer Guy Anderson, and Board Chairman George Longphee.

Balance Sheet

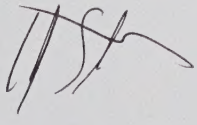
Reflection Resources Ltd.
October 31, 1985

	1985	1984
Assets		
Current Assets		
Cash	$ 43,452	$ 115,315
Term deposit	—	280,620
Accounts receivable	68,454	33,275
Prepaid expenses	4,554	—
	116,460	429,210
Fixed Assets (Note 4)	920,022	731,851
Deposits, at cost	9,050	5,550
	$ 1,045,532	$ 1,166,611
Liabilities		
Current Liabilities		
Bank Loan (Note 5)	13,684	—
Accounts payable and accrued liabilities	255,132	185,996
	268,816	185,996
Deferred Production Revenue	2,555	—
Shareholders' Equity		
Share Capital (Note 6)	1,263,406	1,110,804
Deficit	(489,245)	(130,189)
	774,161	980,615
	$ 1,045,532	$ 1,166,611

Approved on behalf of the Board:



Director



Director

Statement of Loss and Deficit

Reflection Resources Ltd.
For the Year Ended October 31, 1985

	1985	1984
Revenue		
Oil and gas	$ 42,226	$ —
Royalties	5,444	9,541
Interest	10,009	18,967
	57,679	28,508
Expenses		
Operating	15,943	—
General and administrative	164,339	137,197
Interest	2,591	—
Depletion and depreciation	87,904	11,839
Write-down of non-productive properties	145,958	—
	416,735	149,036
Net Loss for the Year	359,056	120,528
Deficit, Beginning of the Year	130,189	9,661
Deficit, End of the Year	489,245	130,189
Loss per share	.11	.04
Funds applied to operations per share	.03	(.02)

Statement of Changes in Financial Position

Reflection Resources Ltd.
For the Year Ended October 31, 1985

	1985	1984
Operating Activities		
Operations:		
Net loss for the year	$ (359,056)	$ (120,528)
Add (deduct) items not affecting cash		
Depletion and depreciation	87,904	11,839
Write-down of non-productive properties	145,958	—
	(125,194)	(108,689)
Net change in non-cash working capital items related to operations	29,403	167,623
	(95,791)	58,934
Financing Activities		
Issuance of share capital	187,602	600,000
Agent Fees	(35,000)	(100,000)
Organizational costs	—	(96,196)
	152,602	403,804
Investing Activities		
Acquisition of fixed assets	(422,033)	(156,690)
Deposits	(3,500)	(5,550)
Deferred production revenue	2,555	—
	(422,978)	(162,240)
Change in Cash and Equivalents During the Year	(366,167)	300,498
Cash and Equivalents, Beginning of the Year	395,935	95,437
Cash and Equivalents, End of the Year	29,768	395,935
Cash and Equivalents are composed of the following:		
Cash	43,452	115,315
Term deposit	—	280,620
Bank loan	(13,684)	—
	29,768	395,935

Notes to the Financial Statements

Reflection Resources Ltd. October 31, 1985

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Consolidation

Prior to October 31, 1985, the consolidated financial statements included the accounts of Reflection Resources Ltd. Subsequent to the Business Combination and Amalgamation described in Notes 2 and 3, these consolidated financial statements reflect the activities of the Amalgamated Company and its wholly owned subsidiaries Corsair Petroleum Inc. and Teebay Oil and Gas Inc.

(b) Petroleum and Natural Gas Properties

The Company follows the full-cost method of accounting for petroleum and natural gas properties whereby all costs of exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenses, lease rentals on undeveloped properties, costs of drilling both productive and non-productive wells, and all technical overhead directly related to exploration and development activities. All other general and administrative costs and interest costs are expensed. No gains or losses are recognized upon the sale or disposition of petroleum and natural gas properties held for exploration and development except for transactions which result in major disposals of petroleum and natural gas reserves.

Grants received and accrued under the Petroleum Incentive Program have been credited to the cost of petroleum and natural gas properties.

Depletion of petroleum and natural gas properties is calculated on the unit-of-production method based upon estimated proven reserves as determined by the Company and independent engineers.

Production equipment is depreciated on the declining balance basis using a rate of 30%.

Other assets are depreciated on the declining balance basis using a rate of 20%.

The Company applies a ceiling test to capitalized costs to ensure that such costs do not exceed the estimated present value of future net revenues from production of proven reserves at current prices and costs, plus the estimated fair market value of unevaluated properties.

Substantially all of the exploration and development activities of the Company are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

(c) Deferred Production Revenue

Proceeds received or liabilities assumed under take-or-pay provisions of gas sales contracts are deferred and taken into revenue as production occurs or upon expiry of the contract.

(d) Foreign Currency Translation

The Company follows the temporal method when translating foreign currency transactions and the financial statements of foreign subsidiaries. Under this method monetary items are translated at the rates of exchange prevailing at the balance sheet date, non-monetary items are translated at historic exchange rates, and revenues and expenses (other than depletion and depreciation) are translated at average rates of exchange during the year. The resulting gains or losses are charged to earnings.

(e) Revenues from oil and gas sales are recorded net of applicable royalties.

2. BUSINESS COMBINATION

Effective October 31, 1985, Reflection Resources Ltd. acquired all of the outstanding shares of Corsair Petroleum Ltd. for an aggregate consideration of $152,602, net of agent commission of $35,000. The business combination has been accounted for as a purchase and the results of operations of Corsair Petroleum Ltd. have been included in these consolidated financial statements from the date of acquisition and amalgamation (see Note 3). The value assigned to the fixed assets acquired was based on reserve valuations carried out by independent engineers and is subject to the accounting policies outlined above.

The acquisition is summarized as follows:

Working capital deficiency	$(113,143)
Fixed assets	303,300
Deferred production revenue	(2,555)
Total share capital consideration	$187,602

3. AMALGAMATION

On October 31, 1985, Reflection Resources Ltd. and Corsair Petroleum Ltd. entered into an Amalgamation Agreement pursuant to and in accordance with the Business Corporations Act of Alberta.

The provisions of the Amalgamation Agreement include the following:

(a) Reflection and Corsair each contributed all of their property and assets, subject to all of their liabilities, to the Amalgamated Company.

(b) The authorized and issued share capital of Reflection were converted on a share for share basis into the authorized and issued share capital of the Amalgamated Company.

(c) The issued common share capital of Corsair was converted on a 3 for 1 basis into common share capital of the Amalgamated Company.

(d) The authorized and issued common share capital of Corsair were cancelled.

(e) The name of the Amalgamated Company became Reflection Resources Ltd.

4. FIXED ASSETS

	1985			1984
	Cost	Accumulated Depletion and Depreciation	Net Book Value	Net Book Value
Petroleum and natural gas properties				
Canada	$ 785,171	$92,035	$693,136	$731,851
United States	110,900	—	110,900	—
Production equipment				
Canada	25,694	7,708	17,986	—
United States	96,000	—	96,000	—
Other	2,000	—	2,000	—
	$1,019,765	$99,743	$920,022	$731,851

5. BANK LOAN

The bank loan is due on demand, bears interest at bank prime rate plus 1% and is secured by a general assignment of accounts receivable.

6. SHARE CAPITAL

(a) Authorized:

Effective October 31, 1985, pursuant to the Articles of Amalgamation, the authorized Share Capital became as follows:

(i) Unlimited number of voting common shares of no par value.
(ii) Unlimited number of non-voting first preferred shares of no par value.
(iii) Unlimited number of non-voting second preferred shares of no par value.

(b) Issued:

	Number of Shares	Ascribed Consideration
Issued for cash	600,000	$ 120,000
Issued in exchange for petroleum and natural gas properties	1,700,000	587,000
Issued at public offering	1,000,000	403,804
Balance at October 31, 1984	3,300,000	1,110,804
Issued on Amalgamation with Corsair Petroleum Ltd. (see Notes 2 and 3)	2,238,336	152,602
	5,538,336	$1,263,406

Pursuant to an agreement, the Company agreed to issue 250,000 common shares to the agent who assisted in the Amalgamation of Reflection with Corsair. Although these shares were not issued until subsequent to October 31, 1985, the ascribed value of the shares of $35,000 has been reflected in these consolidated financial statements as an accounts payable and a corresponding reduction in the ascribed value of the net assets acquired from Corsair on amalgamation (see Notes 2 and 3).

7. RELATED PARTY TRANSACTIONS

During the year, the Company incurred consulting fees of $96,351 as a result of transactions with companies controlled by directors of the Company. These transactions were under the same terms and at similar prices as transactions with independent third parties.

8. LOSS PER SHARE

The calculation of loss per share and funds applied to operations per share are based on the weighted average number of shares outstanding during the year.

9. INCOME TAXES

The Company has incurred losses for income tax purposes amounting to $655,000 that are available to be carried forward and applied against future taxable income. No provision has been made in these consolidated financial statements to reflect any future possible benefit of these losses.

10. COMPARATIVE FIGURES

Certain of the prior years figures presented for comparative purposes have been reclassified to conform with the current years financial statement presentation.

11. SUBSEQUENT EVENTS

(a) Pursuant to an agreement dated September 6, 1985, the Company proposes to acquire 100% of the issued share capital of Blackrock Energy Ltd. in return for the issue of 1,800,000 common shares of the Company.

(b) Pursuant to the amalgamation of Reflection with Corsair (see Notes 2 and 3) and the proposed acquisition of the issued share capital of Blackrock Energy Ltd., the Company has issued 500,000 common shares to the agent who assisted with the above transactions. Should the proposed transaction with Blackrock not be completed, 250,000 common shares will be returned to the Company by the agent.

Auditors' Report

To the Shareholders

We have examined the consolidated balance sheet of Reflection Resources Ltd. as at October 31, 1985 and the consolidated statements of loss and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at October 31, 1985 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Ward Mallette

Chartered Accountants
Calgary, Canada
January 20, 1986

Corporate Information

Annual Meeting

The Annual General Meeting of the Shareholders of Reflection Resources Ltd. will be held at 2:00 p.m. on March 27, 1986 in the Western Canadian Place Conference Centre, Room A, Plus 30 Level, 700 Ninth Avenue S.W., Calgary, Alberta.

Executive Offices

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Calgary, Alberta

Murray J. Stapleton
Priddis, Alberta

George Longphee
Sidney, British Columbia

Donald V. Basso
Calgary, Alberta

Robert E. Hyde
Calgary, Alberta

Officers

Guy R. Anderson
President and Chief Executive Officer

Murray J. Stapleton
Treasurer and Chief Financial Officer

Darold H. Parken
Secretary

Transfer Agents and Registrars

The Canada Trust Company at its principal offices in Vancouver, Calgary, Regina, and Winnipeg.

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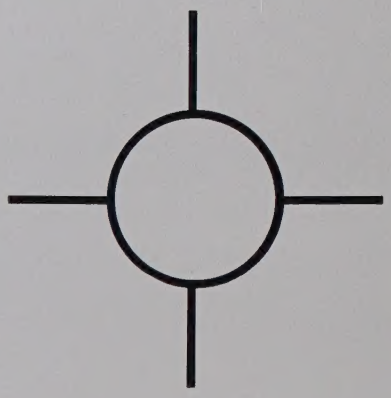

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